



## **OXFORD ANALYTICA**

### **BRAZIL**

### **MONETARY TRANSPARENCY**

**Country Report 2005**

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# BRAZIL



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2005	2004	2003	2002
Clarity of roles	...	...	...	...
Open decision process	....	....	....	....
Availability of information	.....	.....	....	....
Central bank accountability	....	....	....	....
<b>Score</b>	<b>4.00</b>	<b>4.00</b>	<b>3.75</b>	<b>3.75</b>

## OUTLOOK & COMMENTARY

Granting legal autonomy to the Central Bank of Brazil (BCB) is the most important issue to address in order to improve monetary policy transparency practices. However, the current situation in Congress -- where different members are being investigated for corruption allegations -- will prevent any further progress in this area in the near future.

The new organisational structure at the BCB for bank supervision is likely to overcome the current shortcomings in this area. The comprehensiveness and reliability of publicly available information and data continues to consolidate their role as important reference tools.

## EXECUTIVE SUMMARY

### 4.00 Compliance in progress

Brazil complies with many of the standards set out in the IMF 'Code of Good Practices on Transparency in Monetary Policy'. The Central Bank of Brazil (BCB) identifies its principal objective as being to promote the stability of the purchasing power of the Brazilian currency and the soundness of the nation's financial system. Little progress has been made in the past year in granting operational autonomy to the BCB, but government officials and BCB staff remain clear in their determination to institutionalise its de facto autonomy.

The framework, instruments, and targets of monetary policy in Brazil are clear and publicly available. The BCB commitment to high standards of transparency and a good communication strategy, together with a well-trained staff, have been reinforced in the past year. The central bank employs a variety of instruments to achieve its monetary policy objectives, including open market operations and liquidity support loans. Consistent policy implementation over the past five years by two different administrations has been a key component of monetary policy consolidation.

The BCB has a comprehensive programme of regular publications -- including an *Inflation Report*, a *Monthly Bulletin*, and a *Financial Stability Report* -- all of which are publicly available. The central bank publicly discloses its balance sheet -- including audited revenues and expenses -- in the *Annual Report*. The BCB's website serves as an important source of information on recent economic developments, monetary and survey data, the minutes of the Monetary Policy Committee meetings, and a range of relevant contacts. The BCB's Investor Relations Programme provides adequate and timely information to market participants, including statistics on main macroeconomic variables.

As a result of a strategic review and analysis of activities, the BCB has improved its organisational structure in the banking supervision area. Brazil has released a timetable for implementation of the International Convergence of Capital Measurement and Capital Standards -- commonly known as Basel II -- which is scheduled to occur gradually from 2005 to 2011. During this year, the management of external debt has been fully transferred from the BCB to the National Treasury, increasing efficiency in debt management.

Brazil's overall score remains unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS



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### The objectives and institutional framework of monetary policy

#### Central bank objectives and responsibilities

Brazil's institutional framework for monetary policy is set out in Law 4.595 of 1964 (as amended) and also in Decree 3.088 of 1999, which established an inflation-targeting framework. This Law regulates the Brazilian financial system, and provides the legal foundations of the Central Bank of Brazil (BCB) and the National Monetary Council (CMN). As the government's most important economic decision-making body, the CMN is responsible for deciding general monetary policy, including setting the headline inflation rate, as well as foreign exchange and credit policies. The CMN also regulates and coordinates the regulation and supervision of financial institutions. Composed of the minister of finance (who serves as its chairman), the minister of planning and budget, and the BCB governor, the body has three voting members. The monetary decisions of the CMN are then implemented by the BCB.

The BCB identifies its principal objective as being to promote the stability of the purchasing power of the Brazilian currency and the regulation and supervision of the nation's financial system. This goal, however, is qualified by the need to adjust its money supply and interest rate policies according to the needs of sustainable economic growth and development. The BCB also includes among its duties the formulation and management of monetary and foreign exchange policies in accordance with the guidelines given by the government, and the managing of the Brazilian Payment System.<sup>1</sup>

In the government's 2004-2007 Multi-Year Plan (PPA), BCB objectives and guidelines were outlined, including a strong commitment to the interest of the citizen and to transparency in its actions. In addition, quality of information should continue to be timely and user-friendly, but with a reduction in the time and cost of production. At the same time, integration of the systems of planning, budgeting, financial control and assessment of organisational performance should be strengthened through better use of the available resources.<sup>2</sup>

Within the BCB, the most important body is the Monetary Policy Committee (COPOM). Created in 1996, the COPOM is tasked with setting short-term interest rates in line with the CMN's chosen headline inflation target. The interest rate target set by the COPOM is the target for the Sistema Especial de Liquidação e Custódia (SELIC) interest rate, the interest rate for overnight inter-bank loans collateralised by government bonds registered with and traded on the SELIC. The COPOM has the final say in monetary policy management in order to achieve inflation targets set by the CMN. Operational disagreements between the COPOM and the CMN are unusual.

#### Operational autonomy

Brazil's central bank is not legally independent, but in practice enjoys substantial operational autonomy.<sup>3</sup> Consistent policy implementation over the past five years by two different administrations has been a key component of monetary policy consolidation. The BCB's de facto operational autonomy ultimately reflects its success since 1999 in building credibility as an inflation-fighting institution.<sup>4</sup> The IMF has recently observed that the effectiveness of monetary policy could be enhanced by the passage of legislation to provide the BCB with full operational autonomy.<sup>5</sup>

The approval of Constitutional Amendment 40 in May 2003, which relaxed certain procedural restrictions imposed on the national monetary and fiscal system by Constitutional Article 192, has made any reform to the central bank's legal status both politically and procedurally easier by making it possible through a supplementary law. While the amendment has no legal impact on the status or operations of the BCB, it was a symbolic first step in the government's plans to introduce a bill extending legal autonomy to the central bank.

A reform of BCB operations (including its operational autonomy) will need not only central government's efforts, but also consensus at the congressional level -- especially within the governing Workers' Party, which currently appears divided on this issue.<sup>6</sup> Some commentators suggested that the government has not yet settled on a model for central bank independence/autonomy. Draft bills affecting the BCB's status have been prepared individually by a number of legislators, but these are unlikely to be discussed until the government defines a broad strategy to address central bank autonomy.

During the past year, the government has renewed its efforts to gain congressional approval to grant autonomy to the central bank. However, corruption allegations involving both members of the executive and the legislative branches have brought major reforms in the country to a standstill. Government officials and BCB staff remain determined to institutionalise the BCB's de facto autonomy.<sup>7</sup> Ensuring the BCB's de jure independence would further develop credit markets, help reduce output volatility, and increase the effectiveness of monetary policy.

## **Institutional relationship between monetary and fiscal operations**

### **Lending to government**

Article 164 of the Federal Constitution forbids the BCB to finance the National Treasury. In particular, the central bank may not grant loans to the treasury, or to any agency or entity that is not a financial institution. Also, it may not buy primary issues of federal debt. In addition, the Fiscal Responsibility Law (LRF) prohibits the central bank from issuing securities in order to finance federal government debt.<sup>8</sup> Treasury balances held at the central bank are remunerated at the average interest rate for all government securities in the BCB's portfolio. Outstanding credits, advances, and overdrafts made by the BCB to the government are reported in the BCB's annual accounts.

### **Central bank involvement in the rest of the economy**

The only significant involvement of the BCB in the rest of the economy is through its control of three commercial banks transferred to the BCB for recapitalisation and re-privatisation -- Banco do Estado de Santa Catarina, Banco do Estado do Ceará, and Banco do Estado do Piauí.

### **Central bank profit allocation**

Allocation of central bank profits is specified in Article 7 of the LRF, and in the Provisional Measure 2179-36 of 2001. Under the law, all central bank financial results are classified as National Treasury revenue. Any profits must be transferred within ten business days after the approval of the half-year balance sheets. Any negative results will be classified as a National Treasury liability, and the Treasury will cover the loss within one year of final approval of the balance sheets. Should the Treasury deem it appropriate, and with the concurrence of the BCB's governor, the central bank may retain up to 25% of any profits.<sup>9</sup> The LRF also requires that the impact and fiscal cost of the central bank's operations be stated quarterly in the federal government's Budgetary Directives Law. A breakdown of the BCB's balance sheets is reported on its website.

## Agency roles performed by the central bank on behalf of the government

The BCB manages the National Treasury account on behalf of the government. Starting in January this year, the management of external debt has been fully transferred from the BCB to the National Treasury. All management stages, including the establishment of guidelines and strategies, risk management, market decisions and budgetary controls are now centralised at the Treasury. The transition process has been conducted smoothly, with close collaboration between both institutions, and has increased efficiency in debt management -- including long-term planning -- and information disclosure.<sup>10</sup>

The BCB represents the Brazilian government in its dealings with international organisations such as the IMF and the Bank for International Settlements. Open market operations conducted by the BCB are reported in the monthly *Domestic Federal Public Debt and Open Market Operations Monthly Press Release*, published jointly by the BCB and the National Treasury, and available online.<sup>11</sup>

According to a recent report, a comprehensive regulatory framework to combat money laundering is in place. Law 9.613 of 1998 and sector-specific regulations broadly ensure compliance by the financial sector. Some deficiencies should be addressed, like the legal enactment of informal agreements and the provision of legal assistance outside treaty obligations. Moreover, bank secrecy limits the ability of the securities regulator to fully supervise the sector and exchange information with foreign counterparts. The establishment of specialised regional courts is a positive step and they should demonstrate their effectiveness when they become fully operational.<sup>12</sup>

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●● Compliance in progress

### The framework, instruments and targets of monetary policy

#### Framework and monetary targets

The framework, instruments, and targets of monetary policy in Brazil are clear and publicly available. The BCB website includes a concise description of the procedures and practices followed with regard to monetary policy instruments. Under Decree 3.088, Brazil follows an explicit inflation-targeting framework for monetary policy. Under the Fiscal Responsibility Law, the federal government's Budgetary Directives Laws (which are sent to the Congress six months before the year's draft budget) must include an appendix containing the objectives of the monetary, credit, and foreign exchange policies as well as the parameters and projections for major aggregates and variables, and inflation targets for the subsequent year.<sup>13</sup> In practice, managing the value of the currency has been relegated to a secondary role but remains important.

Brazil has experienced large adverse shocks in the past, which made the attainment of inflation targets more difficult. The BCB commitment to high standards of transparency and a good communication strategy, together with a well-trained staff, has allowed the BCB to maintain credibility in such an environment.<sup>14</sup> Some commentators have remarked that the BCB's adherence to inflation targeting appears to be stricter than in previous years. For 2005, the target was fixed at 4.5% with a 2.5% band on either side. The relatively large interval for inflation targeting (2-7%) is likely to be reduced in 2006 with a 4.5% target and a 2% band on either side.<sup>15</sup>

The BCB is charged with the task of purchasing foreign exchange in the market with the objective, after fulfilling the needs of the National Treasury for payments of interest and principal on bonds and of Paris Club liabilities, of promoting a gradual accumulation of international reserves.<sup>16</sup> The current BCB foreign exchange purchasing policy, which began in January 2004, is guided mainly by liquidity conditions in the market at each moment. According to BCB officials, the process should be understood as an effort to accumulate international reserves in the context of an inflation-targeting policy framework with a floating exchange rate. It should not be confused with the establishment of any other targets for central bank action, such as a floor or a ceiling for the exchange rate.<sup>17</sup>

In March this year, following the National Audit Court's recommendations, the government has made a further step towards the fully liberalisation of the exchange market. The opening, imposed by BCB Resolution 3.265, facilitates the purchase of dollars and their transfer abroad, abolishing limits on volume and legal restrictions. Anyone is now able to buy and transfer dollars or other foreign currencies to other countries, in any amount, with the sole requirement of informing the authorities of the purpose of those transfers. The measure eliminates all controls on capital flows, and aims to attract investment on the assumption that capital will enter the country more freely if it can easily be withdrawn.<sup>18</sup>

BCB relationships with counterparties are specified in a series of circulars delivered directly to financial institutions and available on its website.<sup>19</sup>

### **Monetary instruments**

The central bank employs a variety of instruments to achieve its monetary policy objectives, including open market operations and liquidity support loans. Once the headline inflation target has been set by the CMN, the BCB sets the SELIC interest rate, a key instrument for monetary policy.

The BCB exercises monetary and credit controls by setting reserve requirements for commercial banks and through bank rediscount policies. In addition, interest rate ceilings and mandatory rate reductions are used. The government also imposed lending requirements on banks, although they are increasingly being reduced. For example, it requires commercial banks to set aside a portion of their net deposits for agricultural loans and house lending facilities. There are additional limitations on credit in the form of reserve requirements on both time and demand deposits and on credit-allocation requirements for small businesses.

## **The monetary policy-making body**

### **Monetary board**

The Monetary Policy Committee (COPOM) is composed of the nine members of the BCB's Board of Directors: its governor, and the deputy-governors for Monetary Policy, Economic Policy, Special Studies, International Affairs, Financial System Regulation, Financial Supervision, Bank Liquidation and Privatisation, and Administrative Affairs.<sup>20</sup> The governor holds the deciding vote in cases where the COPOM is evenly split on a monetary policy decision. The BCB's website contains a detailed description of the COPOM's composition, structure and practices.<sup>21</sup>

The COPOM is charged with setting the SELIC interest rate target, which is fixed for the period between regular COPOM meetings. The COPOM can also establish a monetary policy bias at its regular meetings. This authorises the governor to alter the SELIC interest rate target in the direction of the bias at anytime between regular COPOM meetings. If inflation breaches the target set by the CMN, the governor is required to write an open letter to the minister of finance explaining the reasons the target was missed, as well as the measures required to bring inflation back to the target, and the time period over which these measures are expected to take effect.

Procedures for appointment of central bank officials are specified in Law 4.595. The president appoints the governor and deputy governors with confirmation from the Senate. However, the legislation does not specify any terms of office for high BCB officials, and they can be removed at any time by the president without the Senate's approval.

### **Advance meeting schedule**

The BCB's website includes an annual advance meeting schedule for COPOM meetings. Since 2000, the COPOM's regular meetings have been held once per month; the meetings last two days. The meeting begins on a Tuesday and continues on the following day.

The BCB's website contains a calendar of COPOM meetings which is regularly updated, and explains its activities in some detail. Eight days after each meeting, the committee releases the minutes via the website. The minutes -- which have been enhanced in the past year -- discuss the considerations behind COPOM decisions. Dissenting views are included in the minutes if the decision is not unanimous. Short statements are released immediately after COPOM meetings.



## Public statements on monetary policy

### Periodic publications

The BCB has a comprehensive programme of regular publications, all of which are available through its website in both Portuguese and English. Data on the monetary base and its components is published in the monthly press release on monetary policy and credit and in the BCB's *Monthly Bulletin*. Information publicly available through the *Monthly Bulletin* includes detailed data on capital and financial markets, public finance, balance of payments, and an overview of the international economy. In addition, explanatory notes are provided for some chapters. At the end of each quarter (March, June, September, December), the COPOM publishes the *Inflation Report*, which provides detailed information on economic conditions, as well as the inflation projections from its most recent meeting. In recent years, information available through the *Inflation Report* has increased, and now includes analysis of the economic activity and price evolution; credit, monetary and fiscal policies; and inflation outlook. Weekly press releases are also available.

Since November 2002, the BCB has been publishing the *Financial Stability Report*. This report -- published twice a year -- provides information on the condition of the financial system, including banking sector assets and liabilities, exchange rate exposure, and capital adequacy ratios. The publication also describes the condition of the nation's payments system and reports on any changes to the framework of prudential regulation. Stress scenarios and their monetary implications are also outlined.<sup>22</sup> The *Financial Stability Report* has developed into an important reference tool, providing a reliable picture of the position and operations of financial institutions.<sup>23</sup>

To generate its forecasts, the BCB uses its own macroeconomic model, based on projections prepared by the Economic and the Research Departments. While not all the variables and parameters of the model are made public, Working Papers posted on its website provide some detail about the model and the assumptions used.

### Public hearings

The BCB is not legally required to conduct public hearings or consultations before monetary policy changes. In practice, however, central bank staff meets on a quarterly basis with economists from the private sector and representatives of various sectors of the economy to discuss their views on regulatory and monetary policy. The BCB has an active policy of seeking commentary from social sectors affected by monetary policy decisions.

## Regulations on data reporting by financial institutions to the central bank

The BCB is in charge of monitoring and regulating the nation's financial system, although it shares these responsibilities with other government entities. Its responsibilities include the regulation, authorisation and monitoring of the activities of leasing companies, real estate credit societies, savings and loan associations, the National Rural Credit System (SNCR), and the Farming Activity Guarantee Programme (Proagro).<sup>24</sup> The regulation, authorisation and monitoring of the activities of mutual funds, previously the responsibility of the BCB, were transferred to the Securities and Exchange Commission of Brazil (CVM) in 5 April 2004.<sup>25</sup>

A critical element of the central bank's supervisory process is the on-site inspection of financial institutions. Monitoring and systematic analysis of financial reports to assess risks assumed by institutions, and control of compliance with established limits and other regulations are essential parts of the BCB's supervisory tasks.<sup>26</sup> These procedures are conducted by means of the off-site supervision process. The central bank has developed a Supervision Manual in order to assist in performing on-site inspection and off-site monitoring, and to enable

financial institutions and the public in general to become familiar with the objectives and procedures adopted by the BCB.<sup>27</sup> Administrative procedures undertaken by the BCB against financial institutions are reported at its website.<sup>28</sup> In late 2004, Banco Santos -- a middle-size bank in San Paulo state -- was the subject of an intervention by the BCB in accordance with established regulations.

The central bank releases -- on a quarterly basis -- a report on the largest fifty bank conglomerates and independent banking institutions operating in Brazil, ranking banks -- in decreasing order -- based on their amounts of 'Total Assets Less Brokerage'. The first version is released 60 days after the end of the quarter, with the second and final one released 30 days later. In accordance with Law 4.595, financial institutions must determine their income as of June 30 and December 31 of each year, in observance of the accounting rules established by the CMN.

The BCB produces a Document Catalogue (CADO) listing all the documents that institutions are obligated to submit to it. It also publishes an Accounting Plan of National Financial System Institutions (COSIF), which describes accounting records and the different types of accounts to be used by any institution, cooperative, bank, distributor, or broker. Both documents are available by subscription.

In July this year, a new organisational structure in the bank supervision area at the BCB started to operate. The new structure is the result of a strategic review and analysis of supervision activities, and aims to bring together similar or complementary processes under a common organisational unit. The change also takes into considerations the growing need for better coverage of credit unions, micro-credit agencies, and financial institutions that are not subsidiaries of banking conglomerates.

In December 2004, Brazil released a timetable for implementation of the International Convergence of Capital Measurement and Capital Standards -- commonly known as Basel II.<sup>29</sup> The framework lays out the broad elements for implementation of the three pillars of the new capital accord, to be applied uniformly to all institutions within the Brazilian financial system regardless of nationality of ultimate ownership. The introduction of Basel II is likely to occur gradually from 2005 to 2011.

Legal provisions aimed at subjecting the financial system to the anti-trust authority were submitted to Congress but no progress has occurred in this area.

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●●● Full compliance

#### Release of central bank data

Brazil subscribes to the IMF Special Data Dissemination Standard (SDDS) and meets its standards for coverage, periodicity, and timeliness of monetary data.<sup>30</sup> Timely information on the country's monetary base is publicly available. An advance release calendar giving one quarter ahead notice of approximate release dates is published on the central bank's website and on the IMF Dissemination Standards Bulletin Board. A calendar for the entire following year is published each December on the BCB's website. A regular notice on the advance release calendar is also published in the *Monthly Bulletin*.

Data for the analytical accounts of the central bank are preliminary when first disclosed. Preliminary data are duly identified and are subject to revision. The data become final after the approval of the board, four weeks after the end of the reference month. An extensive range of time-series data is available in the *Economic and Financial Information* section on the BCB's website.

#### The central bank balance sheet

The central bank publicly discloses its balance sheet in the *Monthly Bulletin* and its *Annual Report*. The balance sheet details credits to financial institutions, securities and open market transactions, National Treasury transactions and external liabilities. Information on National Treasury revenues and expenditures, public sector borrowing requirements, and the central bank portfolio is also publicly available. An assessment on the Brazilian economy and its public finances is usually included in the *Annual Report*. The methodology used to compile the data is well documented. The BCB reports daily on the amount and composition of international reserves.

The BCB is taking steps towards adopting the International Accounting Standards issued by the International Accounting Standards Board (IASB). In order to deal with situations outside the scope of the IASB, the BCB intends to observe the best accounting practices of other central banks.<sup>31</sup> The balance sheet to be closed on December 31, 2005 will be the first to be published under the new accounting rules. The following year, the first comparative balance sheet may be disclosed.<sup>32</sup>

The analytical balance sheet, published in the *Monthly Bulletin*, includes the accounts of the BCB (arranged to facilitate economic interpretation), together with a consolidated statement of the foreign assets and liabilities of the public sector, and accounts of the National Treasury. The following assets data are published: foreign assets; credit to the federal government; credit to state and municipal governments; credit to the private sector; credit to deposit money banks; credit to other banking institutions; and credit to non-bank financial institutions. The BCB does not extend credit to non-financial public enterprises.

The central bank has contingent liabilities, including restitution claims and other risks inherited from financial institutions under liquidation, but these liabilities have already been incorporated into the BCB's balance sheet.

## Lender of last resort

Whenever the central bank acts as a lender of last resort, it must conform to established rules and reporting in its balance sheet. Such support is given through loans by the BCB to assist financial institutions facing temporary liquidity problems. The loan is granted for one day, through standardised repurchase agreement transactions.

In November 1995, with the creation of the Programme of Incentives for the Restructuring and Strengthening of the National Financial System (PROER), the financial system incorporated a liquidity assistance mechanism. However, the Fiscal Responsibility Law precludes its application under the original conditions. Despite this, the BCB guarantees the confidentiality of data relating to specific financial institutions or individuals, in accordance with the established banking oversight standards set forth in the IMF SDDS.<sup>33</sup> Some aggregate information about the costs of restructuring was included in a 2003 Working Paper.<sup>34</sup>

## Public information services

The BCB's high-quality website is part of its comprehensive and reliable communications strategy, and serves as an important source of information on recent economic developments, monetary and survey data, the minutes of COPOM meetings, and a range of relevant contacts.<sup>35</sup> Information publicly available online also includes press releases concerning domestic federal public debt and open market operations, methodological notes on monetary policy and financial system credit operations. In 2004, the BCB launched an improved English website. The new information architecture and the new features designed to support navigation are user-focused, offering information and easy access to exchange and interest rates data. Investor Relations contents are now on the homepage, showing the latest reports. A catalogue for online publications and release dates is also publicly available.

A quarterly *Inflation Report*, publicly available online, is considered both reliable and comprehensive.<sup>36</sup> Other BCB publications include the *Quarterly Monetary Programme*, its *Open Market Report* (with timely information on the central bank's primary and secondary market operations), and the *Annual Report*. In addition, the *Monetary Policy and Financial System Credit Operations Report* provides information on monetary aggregates and financial system credit operations. A variety of Working Papers and Technical Notes on specific topics of monetary significance are regularly posted on the BCB's website. Press releases provide information on monetary and fiscal policies and open market operations. In addition, presentations made by BCB officials are publicly available.

The BCB provides useful monthly below-the-line data on the consolidated operations of the various levels of government and the non-financial public sector. The BCB publishes data on nominal interest payments for different levels of government and their primary balances. It also publishes on a monthly basis statistics on the uses and sources of financing government operations, for all levels of government and the consolidated public sector.

The Investor Relations Department within the central bank is in charge of collecting information used in the *Market Expectations Report* (MER), which is based on the main short and medium-term macroeconomic forecasts for the country's economy prepared by independent analysts and consulting firms. Variables forecast include inflation trends, GDP growth, exchange rate fluctuations, SELIC targets, industrial production, foreign direct investment, and trade balance among others. Commentators have praised the comprehensiveness, reliability and professionalism of the MER, which is released to the public on Monday each week.<sup>37</sup>

The BCB has been developing a reliable Investor Relations Programme (IRP), which provides adequate and timely information to market participants, including statistics on main macroeconomic variables. Reports released through the IRP also include economic developments, regulatory topics, and policy announcements.<sup>38</sup>

#### 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●●● Compliance in progress

##### **Accountability before a designated public authority**

Under the Fiscal Responsibility Law, the BCB is required to present, in a joint meeting with the relevant commissions of Congress, an evaluation of compliance with the objectives and targets of monetary, credit, and foreign exchange policies, detailing the impact and the fiscal cost of its operations and the results shown in its financial statements. The presentation -- available through the BCB website after its submission before Congress -- must take place within 90 days from the end of each half-year period.<sup>39</sup>

The BCB's *Annual Report* is also submitted to Congress for debate, and the BCB governor appears before the Congress twice a year. At these sessions, the governor and other officials field questions from the legislators on a range of economic policy topics. However, commentators have suggested that the technical capacity of Congress should be strengthened in order to increase its supervisory role.<sup>40</sup>

##### **Financial statement**

###### **Audited financial statement**

Audited revenues and expenses are disclosed in the *Annual Report*. This data is given on a bi-annual basis and compared with results from the previous year. Data includes information on operating revenues, expenditures, and transfers. Methodological notes accompany the released data.

###### **External and internal audit**

Financial statements produced by the BCB are audited both by the Internal Comptroller and by the National Audit Court (TCU), which monitors overall public finances. Since 1999, the BCB has also used an external auditor, although current legislation does not require it. KPMG has acted as the external independent auditor since 2001, and still performs that function.

In late 2004, the TCU released a report recommending that the central bank should increase transparency in its foreign exchange procedures, which are currently being revised. Additionally, the report also pointed out some shortcomings in the relationship between the BCB and financial institutions. Following TCU's recommendations, the BCB has strengthened the functioning of the International Operations Department (DEPIN), including recruiting better trained staff and improving the public availability of information on its operations.

##### **Conduct of officials**

As there is no specific charter for the BCB, ethical standards for public servants have to be found in various pieces of legislation regulating the conduct of public employees. The 1994 Code of Professional Ethics for Federal Public Servants is publicly available and establishes professional behavioural standards for all civil servants. In addition, the 1990 Statute for Civil Servants, applicable to all public employees, sets out individual rights and responsibilities and establishes disciplinary procedures. Sanctions and penalties for officials are further detailed in the Fiscal Crimes

Law of 2000. This law applies to officials from all branches of government and, among other measures, details penalties for individuals who engage in credit operations without due legislative authorisation, who extend loan guarantees without adequate collateral, or who increase personal expenditures in the last 180 days of their period in office.

Also, the government has established a Code of Conduct for senior federal government officials (CCAAF), which is applicable to about 700 government officials who manage public debt. The Code clarifies ethical rules for this category of officials, establishes rules regarding conflicts of interest, and places limitations on professional activities undertaken after leaving office. A Public Ethics Commission (CEP) was set up to implement the CCAAF, but it has limited real power. Upon entry into service, all public officials must supply a declaration of assets as required by the CCAAF. The General Corrector's Office (CGU) conducts investigations into public officials' infractions against federal funds or assets.

The central bank is currently in the process of improving informal governance regulations, in order to institutionalise senior officials' relationship with the media and market participants.

In 2004, accusations of tax evasion were brought against high-ranking members of the BCB, including its president Henrique de Campos Meirelles. These led to the resignation of the director of monetary policy, Luiz Augusto de Oliveira Candiota. Lula granted BCB President Meirelles -- through presidential decree -- cabinet status<sup>41</sup>, a move widely seen as a means of increasing his immunity from prosecution in the event that new evidence is presented. In December 2004, the Senate voted to ratify this decision, and lawsuits against a BCB president may now only be brought before the Supreme Court. The Supreme Court is currently investigating Meirelles, although little progress has been made. Other BCB officials remain without any special form of legal protection. Recent corruption allegations involving both members of the executive and the legislative branches have not been directed against officials of the central bank.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Brazil between 18 and 19 October 2005:

### **Banco Central do Brasil**

#### **19 October 2005**

José Pedro Fachada	Executive Manager	Investor Relations
Katherine Hennings	Adviser	

### **Ministry of Planning, Budget and Management**

#### **18 October 2005**

Antonio Henrique Silveira	Deputy-Chief	Economic Department
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### **National Treasury, Ministry of Finance**

#### **18 October 2005**

Otavio Ladeira de Medeiros	Deputy-Head of Department	Public Debt Management Unit
André Proite	Analyst	Public Debt Management Unit

## ADDITIONAL INTERVIEWS

#### **18 October 2005**

Fernando A. Blanco Cossio	Economist	World Bank Brasilia Office
Aécio S. Cunha	Legislative Consultant	Brazilian Congress

#### **19 October 2005**

Mauricio Mota Saboya Pinheiro	Senior Analyst	Institute for Applied Economic Research
Waldery Rodrigues	Economist	Institute for Applied Economic Research



## NOTES

<sup>1</sup> Banco Central do Brasil, Background & Macro Processes, available at: [www.bcb.gov.br](http://www.bcb.gov.br)

<sup>2</sup> 2004-2007 Multi-Year Plan, available at: [www.planobrasil.gov.br](http://www.planobrasil.gov.br)

<sup>3</sup> 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001, and interviews in Brazil, 18-19 October 2005.

<sup>4</sup> Interviews in Brazil, 18-19 October 2005.

<sup>5</sup> 'IMF Executive Board Concludes 2005 Article IV Consultation with Brazil', IMF Public Information Notice 05/41, March 2005, available at: [www.imf.org](http://www.imf.org)

<sup>6</sup> According to some independent analysts, the government will delay sending a final proposal to Congress until consensus for approval is secured.

<sup>7</sup> Interviews in Brazil, 18-19 October 2005.

<sup>8</sup> Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 34.

<sup>9</sup> Articles 2-3 of the Provisional Measure 2179-36 of August 24, 2001.

<sup>10</sup> Interviews in Brazil, 18-19 October 2005.

<sup>11</sup> *Domestic Federal Public Debt and Open Market Operations Monthly Press Release*, available at: [www.tesouro.fazenda.gov.br/hp/relatorios\\_divida\\_publica.asp](http://www.tesouro.fazenda.gov.br/hp/relatorios_divida_publica.asp)

<sup>12</sup> 'Brazil – Report on the Observance of Standards and Codes – FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism', IMF Country Report No. 05/207, June 2005.

<sup>13</sup> Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 4.

<sup>14</sup> 'Inflation Targeting in Brazil', Henrique Meirelles, October 2004, available at: [www.bcb.gov.br](http://www.bcb.gov.br)

<sup>15</sup> Interviews in Brazil, 18-19 October 2005.

<sup>16</sup> The central bank is not committed to any specific target in this process beyond the general objective of increasing the country's international reserves in the medium term.

<sup>17</sup> Interviews in Brazil, 18-19 October 2005.

<sup>18</sup> Full explanation of BCB Resolution 3265, available at: [www.bcb.gov.br/rex/CNC/Ftp/quadro%201.pdf](http://www.bcb.gov.br/rex/CNC/Ftp/quadro%201.pdf)

<sup>19</sup> See [www.bcb.gov.br/?BUSCANORMA](http://www.bcb.gov.br/?BUSCANORMA), [www.tesouro.fazenda.gov.br/legislacao/download/divida/ato\\_norm\\_demab\\_codip.pdf](http://www.tesouro.fazenda.gov.br/legislacao/download/divida/ato_norm_demab_codip.pdf), and [www.tesouro.fazenda.gov.br/legislacao/download/divida/ato\\_normativo02.pdf](http://www.tesouro.fazenda.gov.br/legislacao/download/divida/ato_normativo02.pdf).

<sup>20</sup> The head of the Investor Relations Office also participates in the COPOM monthly meetings, presenting a summary of latest expectations of market participants on inflation and other macroeconomic variables.

<sup>21</sup> See [www.bcb.gov.br/?SISMETAS](http://www.bcb.gov.br/?SISMETAS)

<sup>22</sup> Banco Central do Brasil, *Financial Stability Reports*, available at: [www.bcb.gov.br/?RED-FINANCSTAB](http://www.bcb.gov.br/?RED-FINANCSTAB)

<sup>23</sup> Interviews in Brazil, 18-19 October 2005.

<sup>24</sup> Article 32 of the Fiscal Responsibility Law and Senate Resolution 43 entrusts the Ministry of Finance with monitoring state and municipal debts. The National Monetary Council indirectly controls the public sector's indebtedness by limiting credit provided by financial institutions to the public sector.

<sup>25</sup> See Decisão Conjunta 10 (May 2, 2002), at: [www.bcb.gov.br](http://www.bcb.gov.br), Instrução CVM 405 (February 27, 2004), and Instrução CVM 409 (August 18, 2004), at: [www.cvm.gov.br](http://www.cvm.gov.br)

<sup>26</sup> The new payment system allows the BCB to monitor the performance of financial institutions more closely. The Brazilian payment system reform represents a second phase of the financial system reform. On the whole, the objective is to reduce the possibility that a crisis in the financial system -- and consequently in the real economy -- may occur.

<sup>27</sup> BCB Supervision Manual, available at: [www3.bcb.gov.br/msv/pesquisa/validate.jsp](http://www3.bcb.gov.br/msv/pesquisa/validate.jsp)

<sup>28</sup> Administrative Punitive Procedures at: [www4.bcb.gov.br/?PAD](http://www4.bcb.gov.br/?PAD)

<sup>29</sup> Schedule for Basel II implementation is outlined in BCB *Communiqué* 12.746 of December 9, 2004.

<sup>30</sup> IMF Special Dissemination Standard (SDDS) – Brazil, at: <http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=BRA>

<sup>31</sup> Conversion of accounting statements to the IASB international standard will take place in three phases. In the first one, the BCB and the consulting firm Ernst & Young have been assessing BCB's operations to conform them to the IASB accounting rules. The second phase involves adapting and reformulating the chart of accounts, the accounting procedures and the managerial systems that interact with the accounting system. The third and last phase will be the disclosure of accounting statements according to IASB rules.

<sup>32</sup> Interviews in Brazil, 18-19 October 2005.

<sup>33</sup> Complementary Law 105, January 2001.



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<sup>34</sup> Ilan Goldfajn, Katherine Hennings, and Helio Mori, "Brazil's Financial System: Resilience to Shocks, No Currency Substitution, but Struggling to Promote Growth," Working Paper No. 75, Banco Central do Brasil, June 2003.

<sup>35</sup> The BCB also regularly conducts surveys in order to assess the utility of its publications.

<sup>36</sup> An independent report produced jointly by the International Centre for Monetary and Banking Studies, and the Centre for Economic Policy Research in 2003 determined the essential elements that a good inflation report should have: central bank's level of expertise; the completeness of the report; the clarity of the writing style; the quality and fullness of the information provided; and whether or not the report is intimidating to economists or non-economists. The study -- available at [www.cepr.org/press/P161.htm](http://www.cepr.org/press/P161.htm) -- ranked each country's Inflation Report and released a top ten list, where Brazil is ranked in third position, after the United Kingdom and New Zealand.

<sup>37</sup> *Market Expectations Report*, available at: [www4.bcb.gov.br/?INVESTOR](http://www4.bcb.gov.br/?INVESTOR)

<sup>38</sup> Interviews in Brazil, 18-19 October 2005.

<sup>39</sup> Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 9, Paragraph 5.

<sup>40</sup> Interviews in Brazil, 18-19 October 2005.

<sup>41</sup> Provisional Measure 207, 13 August 2004.